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Attorneys for Abbott Laboratories

**BEFORE THE ARIZONA CORPORATION COMMISSION**

IN THE MATTER OF THE APPLICATION OF  
ARIZONA WATER COMPANY, AN ARIZONA  
CORPORATION, FOR A DETERMINATION OF THE  
FAIR VALUE OF ITS UTILITY PLANT AND  
PROPERTY, AND FOR ADJUSTMENTS TO ITS  
RATES AND CHARGES FOR UTILITY SERVICE  
AND FOR CERTAIN RELATED APPROVALS  
BASED THEREON.

Docket No. W-01445A-08-0440

**Notice of Filing  
Post-Hearing Brief**

Abbott Laboratories, through its undersigned counsel, hereby submits this Notice of Filing its  
Post-Hearing Brief in the above-referenced matter.

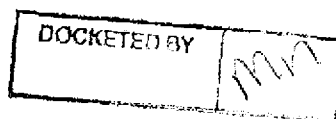
RESPECTFULLY SUBMITTED this 14th day of October 2009.

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Arizona Corporation Commission  
**DOCKETED**

OCT 14 2009



1 An original and thirteen copies of the  
2 foregoing filed this 14th day of October 2009 with:

3 Docket Control  
4 Arizona Corporation Commission  
5 1200 W. Washington St.  
6 Phoenix, Arizona 85007

7 Copies of the foregoing mailed this 14<sup>th</sup> day  
8 of October 2009 to:

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11 ARIZONA WATER COMPANY, AN ARIZONA  
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17 BASED THEREON.

Docket No. W-01445A-08-0440

18 **POST-HEARING BRIEF OF ABBOTT LABORATORIES**

19 **I. INTRODUCTION**

20 Abbott Laboratories ("Abbott") operates a plant located on the west side of Casa Grande within  
21 Arizona Water Company's ("Company's") Casa Grande Certificate of Convenience and Necessity area.<sup>1</sup>  
22 The plant manufactures a variety of infant formula and adult nutritional products.<sup>2</sup> The plant employs  
23 approximately 450 employees and operates 24 hours per day, 7 days per week, 365 days per year.<sup>3</sup>

24 Abbott receives water through a 7-mile dedicated pipeline from one of three Arizona Water  
25 Company wells. The water is chlorinated, but is not otherwise treated prior to delivery. Abbott treats

26 <sup>1</sup> Abbott Ex. 1 at 2:2-7.

27 <sup>2</sup> *Id.*

28 <sup>3</sup> Abbott Ex. 1 at 3:12-15.

1 the water in its own reverse osmosis plant. The Abbott manufacturing plant receives its water through a  
2 6-inch meter.<sup>4</sup>

3 Water is critical to Abbott's Casa Grande operations, and the cost of water significantly impacts  
4 the cost of production.<sup>5</sup> In this case, the Company is proposing rates that, although higher than  
5 Abbott's present rates, are strongly preferred by Abbott over the Commission Staff's proposals in Staff's  
6 final schedules JMM-1 and JMM-3.<sup>6</sup> The Staff's final rate proposal is unjust and arbitrary in that it  
7 would require Abbott to pay in excess of a 90% rate of return on the Company's rate base,<sup>7</sup> almost  
8 double what the Staff agrees it costs the Company to provide Abbott with water service<sup>8</sup> and over 11  
9 times the average rate of return provided by other customer classes.<sup>9</sup> In addition, the Staff propose a  
10 two-tier structure that ignores conservation-promoting rate design principles by failing to recognize  
11 there are two unusually large industrial users in the Casa Grande system using 6-inch meters that already  
12 have, and for some time have had, significant water conservation programs in place. Staff propose an  
13 arbitrary break over point for the first rate tier that is much too low and would include only a small  
14 fraction of Abbott's monthly usage, placing most of Abbott's monthly water usage in the higher rate tier.  
15 The Staff's proposal is unfair to Abbott and other industrial customers in the Casa Grande system and  
16 should be rejected in favor of the Company's more reasonable proposed rate design.

## 17 18 **II. COST OF SERVICE STUDY DEMONSTRATES INEQUITABLE RETURNS AMONG CUSTOMER CLASSES IN THE CASA GRANDE SYSTEM**

19 The concept that water customers similarly situated should be treated similarly is fundamental in  
20 Arizona ratemaking. See A.R.S. § 40-334(B) ("No public service corporation shall establish or maintain  
21 any unreasonable difference as to rates, charges, service, facilities or in any other respect, either between  
22

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23 <sup>4</sup> There is another small metered line on the Abbott property that serves another building but the usage through  
24 that meter is very small.

25 <sup>5</sup> Tr. at 596:8-10.

26 <sup>6</sup> Staff's Final Schedules, docketed September 30, 2009, JMM-1, JMM-3 (Casa Grande, Industrial 6-inch).

27 <sup>7</sup> Tr. Vol. IV at 679:17-25; Abbott Ex. 2, Schedule DLN-2.

28 <sup>8</sup> Tr. Vol. VI at 1068:17-1071:10 (Staff agree with amended cost of service study with slightly different numbers  
for rate base and expenses).

<sup>9</sup> Abbott Ex. 6, JMR-Staff 1, Schedule G-2 at 13.

1 localities or between classes of service.”). In order to determine how classes of customers similarly  
2 situated are treated, Commission rule R14-2-103 requires large water utilities to submit cost of service  
3 study information as part of their rate case application if (1) the utility is in an industry that recognizes  
4 cost of service studies as important tools for rate design and (2) costs incurred by the utility are likely to  
5 vary significantly from one defined segment of customers to another. Both of these conditions are  
6 satisfied in this case because cost of service is a paramount concern in the development of revenues and  
7 rates by customer class in water utility cases<sup>10</sup> and the Company’s cost of service study results in this  
8 case revealed a significant imbalance between the rates of return provided by current rates for customers  
9 similarly situated.<sup>11</sup>

10 The Commission defines “cost of service” as “[t]he total cost of providing service to a defined  
11 segment of customers, as determined by the application of logical and generally accepted cost analysis  
12 and allocation techniques.” A.A.C. R14-2-103(A)(3)(c). There is no dispute in the evidence regarding  
13 the conclusions to be drawn from the Company’s cost of service study. Steve Olea, Utilities Division  
14 Director, agreed with Arizona Water Company’s cost of service study methodology and, after the  
15 company adjusted the allocations as he requested, he had only minor differences of opinion with the  
16 Company’s revenue and expense numbers.<sup>12</sup> Mr. Olea agreed that, with his changes, the industrial  
17 class’ rate of return was higher than the overall rate of return, and Staff’s proposal would under his  
18 truncated cost of service analysis increase to a 72.52% rate of return.<sup>13</sup>

19 The cost of service study results revealed a significant disparity between the rates of return for  
20 the industrial class in the Casa Grande system. Under the current rates, Casa Grande System industrial  
21 customers are providing a 51% rate of return to the Company.<sup>14</sup> In contrast, the other customer classes  
22 are providing returns of 0.18% (residential), 7.63% (commercial), 5.05% (other), and -1.68% (direct  
23

24  
25 <sup>10</sup> Abbott Ex. 2 at 2:17-24; Tr. Vol. IV at 633:5-10; Tr. Vol. III at 641:7-16.

26 <sup>11</sup> Exhibit A-20 at 46:21 – 47:5; Exhibit A-21, Schedule JMR-RBEX2, RB-G2.

27 <sup>12</sup> Tr. Vol. VI at 1068:17 – 1070:10; *see also* Exhibit A-21 at 4:13-19.

28 <sup>13</sup> Exhibit S-10, Schedule SMO-2, G-2.

<sup>14</sup> Abbott Ex. 2 at 3:1-4:13, Schedule DLN-2.

1 private fire).<sup>15</sup> The industrial customers in this system are already paying in excess of 18 times the  
2 average rate of return paid by other customer classes. These results indicate strongly that rates of return  
3 in this rate case should move much closer to the cost of service to correct the imbalance, and the  
4 Company's and the Residential Utility Consumer Office's ("RUCO's") proposed rate designs make  
5 progress toward that goal.

6 Testimony provided at the hearing demonstrated that, in addition to being unfair, inequitable rate  
7 of return paid by the industrial class creates potential revenue instability for the Company if the large  
8 users decrease usage for any reason (including planned conservation)<sup>16</sup>, and also provides incentives for  
9 the Company to avoid serving low return residential customers.<sup>17</sup>

### 10 11 **III. THE COMPANY'S RATE DESIGN IS MORE EQUITABLE TO LARGE INDUSTRIAL** **USERS IN THE CASA GRANDE SYSTEM THAN STAFF'S PROPOSED RATES**

12 Abbott is one of two large industrial customers in the Company's Casa Grande water system that  
13 both pay six-inch meter tariff rates -- the other large customer is Frito-Lay. Abbott and Frito-Lay have  
14 an average water consumption that is 36 times greater than the average monthly consumption of other  
15 commercial and industrial customers using six-inch meters.<sup>18</sup> Experienced utility rate case witnesses  
16 Dan Neidlinger and Steve Olea agreed that this disparity in usage is unusual, and they would usually  
17 expect to see customers this large using a special contract with a utility.<sup>19</sup>

18 Both companies, however, currently pay standard tariff rates. Under Arizona Water Company's  
19 current Casa Grande tariff, Abbott is charged a monthly commodity rate of 1.4869 per 1000 gallons for  
20 the first 2,160,000 gallons and \$1.6500 per 1000 gallons for amounts exceeding 2,160,000 gallons, in  
21 addition to other fees and charges.<sup>20</sup> Mr. Chasse testified these water rates are a significant operational  
22 cost.

23  
24 <sup>15</sup> *Id.*

25 <sup>16</sup> Exhibit A-21 at 8:15 – 9:16.

26 <sup>17</sup> Tr. Vol. IV at 679:25 – 681:19.

27 <sup>18</sup> Tr. Vol. IV at 678:21 – 679:19; 716:12 – 717:6.

28 <sup>19</sup> Tr. Vol. IV at 678:10; 717:7-15; Tr. Vol. VI at 1094:25 – 1095:11.

<sup>20</sup> Abbott Ex. 1 at 3:23 – 4:2; *see also* Exhibit A-20 at 45:17 - 46:3.

1           **A.     The Company's Proposal Moves Rates Closer to Cost of Service**

2           The Company proposes a rate design for the Western Group that would charge a single flat rate  
3 to 6-inch meter industrial customers of \$1.634 per 1000 gallons. The Company's proposed rates provide  
4 a slightly lower 42% rate of return for the consolidated systems than current approximately 51% rate of  
5 return.<sup>21</sup> The Company's proposed rates will provide a return that is still more than double the rate of  
6 return provided by any other customer class in the Casa Grande system, and roughly 3.5 times the  
7 average rate of return provided by other users. Although under the Company's proposed rates the  
8 industrial users will still be providing substantial subsidies to other customer classes, the proposed split  
9 is much more equitable for all users in that all customers will be paying closer to the Company's cost of  
10 providing them with water service.

11  
12                   ***1.     Abbott is already significantly conserving water and additional rate incentives  
                          are unnecessary.***

13           The Company's flat rate proposal for this customer class is also appropriate. The Company's  
14 rate design expert, Joel Reiker, testified in his rebuttal that he believes a flat rate is fair because the  
15 Company's proposed flat commodity rate is already higher than cost.<sup>22</sup> "The proposed flat rate is  
16 representative of what a second tier commodity rate would be under an inverted tier design."<sup>23</sup> In  
17 addition, Reiker noted that both of the largest customers have already begun to implement conservation  
18 measures.<sup>24</sup> An inverted tier rate design is simply not necessary to encourage conservation in this  
19 group.<sup>25</sup>

20           Abbott already has significant financial and environmental incentives to reduce the amount of  
21 water it purchases and uses. First, because water is a significant portion of production cost, Abbott has  
22 ongoing cost incentives to reduce the amount of water it must purchase. In addition, every gallon of  
23 water Abbott purchases must be treated, so a reduction of the volume of water going through the  
24

25 <sup>21</sup> Abbott Ex. 6, Schedule JMR-RBEX2, RB G-2.

26 <sup>22</sup> Exhibit A-20 at 48:14-26.

27 <sup>23</sup> *Id.*

28 <sup>24</sup> *Id.*

<sup>25</sup> Exhibit A-21 at 10:16 – 11:6.

1 treatment processes will reduce treatment, operation and maintenance expenses. Reduction of water  
2 intake into the plant also reduces the volume of wastewater that must be treated.<sup>26</sup>

3 Second, Abbott has identified responsible water use as one of its strategic environmental  
4 priorities. Abbott established a corporate goal of 40% water use reduction by 2011, using Abbott's 2004  
5 usage as a baseline, indexed to sales. Abbott identified the Casa Grande plant as one of its high priority  
6 sites in its global operations based on a review of water supply stress. Abbott's corporate initiatives  
7 have focused and continue to focus additional resources and efforts toward reductions in water use.  
8 These efforts include Abbott's partnership with the University of Arizona and Project WET to promote  
9 water conservation, not only within Abbott's facility, but within the Community. The following chart  
10 demonstrates that the Casa Grande plant has already achieved significant water reductions through  
11 ongoing water conservation efforts and is already ahead of aggressive corporate goals.<sup>27</sup> Abbott has  
12 saved 330 million gallons of water over the past four years with its conservation efforts.<sup>28</sup> Tiering water  
13 rates will simply have no effect on Abbott's significant ongoing conservation efforts.<sup>29</sup>

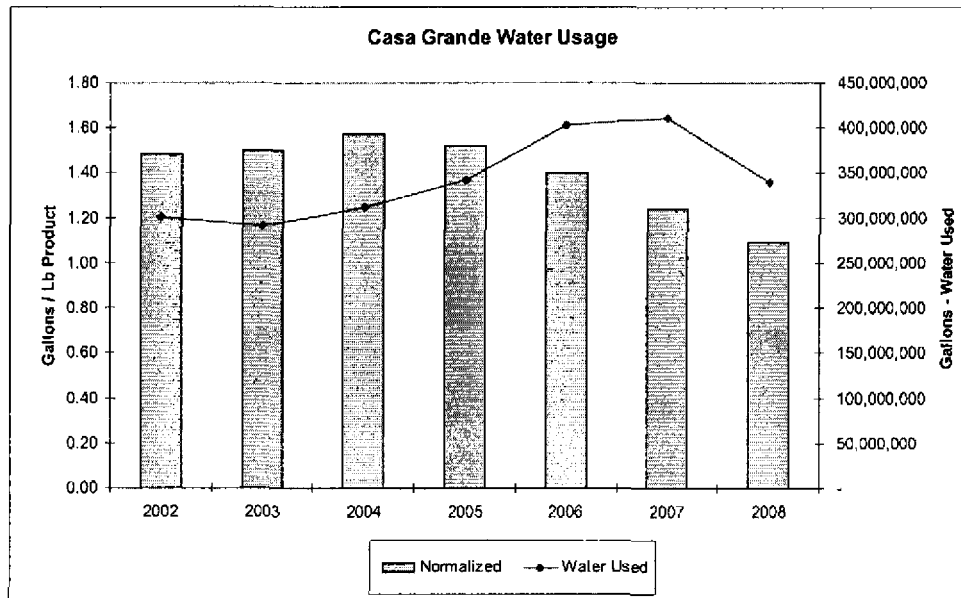
25 <sup>26</sup> Paragraph supported by Abbott Ex. 1 at 4:5-23; *see also* Tr. Vol. III at 596:8-10.

26 <sup>27</sup> Paragraph supported by Abbott Ex. 1 at 4:5 – 5:11; *see also* Tr. Vol. III at 596:1-8.

27 <sup>28</sup> Tr. Vol. III at 601:22-25.

28 <sup>29</sup> Tr. Vol. III at 598:20-24; 602:17-22.





### B. RUCO's Proposal Recognizes the Importance of Cost of Service

Abbott agrees with the rate design recommendations of RUCO for the Casa Grande system since they appear to move customer class returns closer to cost of service.<sup>30</sup> RUCO recommends a flat rate commodity charge of \$1.4826 per 1000 gallons for the 6-inch meter industrial customer in the Western Group – Casa Grande.<sup>31</sup> This is a fair proposal too.

### C. Staff's Proposed Rate Design is Discriminatory and Unfair

The Staff's proposal to increase the rates charged to industrial customers in Casa Grande by over 48% is unfair and discriminatory<sup>32</sup> and should be rejected. Staff propose to increase the 6-inch meter industrial rate to a two-tier rate with the first tier commodity rate at \$1.9760 per 1000 gallons, a second tier at \$2.4680 per 1000 gallons, and a very low break over point of 950,000 gallons.

<sup>30</sup> Abbott Ex. 2 at 2:2-8.

<sup>31</sup> RUCO Final Schedules docketed October 2, 2009, Rate Design Schedule RD-1, Western Group-Casa Grande, pp. 53.

<sup>32</sup> Exhibit A-35 (Staff in Response to 4.14 admit it is not fair and equitable to require industrial users to bear a greater share of the cost of water service than users in other classes); Exhibit A-20 at 6:2-7 and 7:2 – 8:14; Abbott Ex. 2 at 3:1-19.

1 Both the Staff's proposed tier rates are far too high, and are discriminatory to large industrial  
2 users. Staff considered "uniformity" over all other rate design principles. In other words, Staff propose  
3 to charge the same commodity rate for all users, despite having undisputed evidence demonstrating  
4 significant differences in the cost of providing service, and existing overly high rates of return provided  
5 by industrial users.<sup>33</sup> At Staff's proposed rates, industrial customers in the Casa Grande system would  
6 be required to pay 90% above the Company's cost of providing them with water.<sup>34</sup> Staff's proposal  
7 would have industrial users paying over 11 times the average rate of return of the other customer  
8 classes<sup>35</sup>, an unjustifiable subsidy, and an undue burden on Casa Grande businesses.

9 ***1. Staff's proposed tier break over point is unreasonable.***

10 Staff propose a two-tier rate structure with a break over point at 950,000 gallons. This break  
11 over point is far too low for the 6-inch meter industrial customer category because of the two large  
12 users. The average gallons per bill for the customer group into which Abbott falls is 23,801,550, and  
13 the median usage is slightly less than 23,330,000.<sup>36</sup> At Staff's proposed break over point of 950,000  
14 gallons, approximately 96% of water usage will be in the upper rate tier.<sup>37</sup> Rate tiers should not be  
15 designed to punish efficient water use, but instead should be designed to discourage use that could be  
16 wasteful – typically at the upper 5% or 10% of usage.<sup>38</sup>

17 In this class, there is no evidence of any wasteful practice, so tiers are not necessary as was  
18 concluded by both the Company and RUCO. If the Commission wishes to adopt a tier structure  
19 anyway, then a more appropriate break over point for the industrial class is 32,000,000 gallons as shown  
20 in the Staff's alternative rate design.<sup>39</sup> If the Commission is concerned that smaller users may not have  
21 an incentive to conserve at this break over point, then the Commission should separate the smaller  
22

23 <sup>33</sup> See Tr. Vol. IX at 1702:9-23 (Staff did not use cost of service study); see also Abbott Ex. 2 at 6:15 – 7:3;  
24 Exhibit A-21 at 7:2 – 8:14.

25 <sup>34</sup> Abbott Ex. 6, JMR-Staff 1, Schedule G-2 at 13.

26 <sup>35</sup> *Id.*

27 <sup>36</sup> Tr. Vol. IV at 686:3-12.

28 <sup>37</sup> Tr. Vol. IV at 686:3-25.

<sup>38</sup> Tr. Vol. IV at 687:8 – 688:23.

<sup>39</sup> Exhibit S-28.

1 industrial 6-inch meter users from the two large 6-inch meter users in separate rate categories with  
2 specially-tailored break over points. Staff's alternative rate design makes such a change.

3  
4 **2. *Staff's alternative rate design is fairer to industrial users in the Casa Grande system than Staff's proposed rates.***

5 Staff prepared an alternate rate design<sup>40</sup> that would separate Abbott into a separate customer  
6 class in recognition of the significant disparity in water usage between Abbott and other, smaller  
7 industrial customers in the rate tier structure, and also in recognition of the Company's revenue stability  
8 concerns. In the alternative proposal, Abbott would have a first-tier rate of \$1.8000 per 1000 gallons,  
9 and a second tier rate of \$2.7490 per 1000 gallons with a break over at 32,000,000 gallons per month.  
10 This proposal is much more reasonable than the Staff's final proposed rate design, but would still  
11 provide the Company with higher rates of return from the industrial class than are proposed by the  
12 Company and RUCO, and would result in continued high subsidization of other users by the industrial  
13 class.

14  
15 **IV. REQUESTED RELIEF**

16 Of the three parties' rate proposals, the Company and RUCO propose rates for 6-inch meter  
17 industrial users in the Casa Grande system that are much more fair and equitable than the Staff's  
18 proposed rates. Abbott requests that the Commission adopt the Company's proposed rate design for the  
19 6-inch meter industrial clients in the Casa Grande system or consolidated Western Group for all the  
20 reasons described above. For the same reasons, Abbott requests that the Commission reject the Staff's  
21 proposed rates and rate design.

22 [Signature Page Follows]  
23  
24  
25  
26

27 <sup>40</sup> Exhibit S-28.  
28

1 RESPECTFULLY SUBMITTED this 14th day of October 2009.

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